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Brazilian government reduces taxation on non-resident investors

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On 22 September 2022, the federal government issued Provisional Measure 1137 (MP 1137), reducing to zero the withholding tax (WHT) levied as of 1 January 2023 on certain income earned by non-resident investors in the Brazilian financial and capital markets. The measure is part of the Brazilian government's strategy to attract foreign investment into the country.

Foreign investments benefitting from WHT zero rate

According to MP 1137, WHT will apply at a zero rate on income earned by non-resident investors when derived from:

- bonds or securities subject to public distribution, issued by private legal entities, excluding financial institutions, provided that certain regulatory requirements are met;
- receivables investment funds, whose originator or assignor of the receivables portfolio is not a financial institution, provided that certain regulatory requirements are met;
- financial bonds issued by financial institutions; and
- quotas of investment funds that invest, exclusively and in any proportion, in:
 - bonds or securities referred to in the first bullet point above;
 - assets that produce exempt income for foreign investors;
 - federal government bonds; and

- repurchase agreements backed by federal government bonds or quotas of investment fund that invest in such bonds.

The tax benefit brought by MP 1137 applies to investors that are resident or domiciled abroad and carry out financial transactions in Brazil, in accordance with the rules and conditions established by the National Monetary Council.

However, the WHT zero rate may not be enjoyed by foreign investors domiciled in low tax jurisdictions or that benefit from privileged tax regimes, nor when income arises from transactions performed between related parties.

The tax benefit also applies to sovereign funds (ie, investment vehicles established abroad whose assets are made up of resources from the sovereign savings of the country of origin), even if domiciled in low tax jurisdictions.

Changes in taxation of FIPs

MP 1137 also introduces changes in the rules that regulate the taxation imposed on private equity funds (FIPs).

MP 1137 establishes that the WHT zero rate applies on income earned by foreign investors derived from investments in infrastructure private equity funds and private equity funds for intensive economic production in research, development and innovation. In addition, MP 1137 provides that the WHT zero rate also benefits sovereign funds that invest in FIPs, even if domiciled in low tax jurisdictions.

Furthermore, MP 1137 revokes previous tax requirements for the application of the WHT zero rate regarding FIPs' portfolio composition and maximum percentage of quotas held by the same foreign investor.

On the downside, MP 1137 excludes non-resident investors that benefit from privileged tax regimes from the scope of the WHT zero rate in income derived from FIPs. Prior to MP 1137, only investors domiciled in low tax jurisdictions were excluded from the benefit. Discussions surrounding the regimes qualified as privileged by Brazilian tax rules could lead to certain controversies in the application of the WHT zero rate.

Effectiveness of MP 1137

In principle, MP 1137 takes effect from 1 January 2023.

However, as an act issued by the government, MP 1137 has been submitted for the approval of Congress, which has up to 120 days to convert it into law and may introduce changes to its wording or even reject it.

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